



# M e m o r a n d u m

To: Panel Members Date: January 16, 2003

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Subject: PANEL CONSIDERATIONS WHEN A PROSPECTIVE CONTRACTOR EVIDENCES  
FINANCIAL INSTABILITY

You have asked for guidance from the Legal Unit regarding Panel consideration of training projects with companies that may be in sufficient financial difficulty that filing for bankruptcy protection may be a viable option. This memorandum addresses (1) Panel discretion to reject training agreements with companies that may be financially unstable and (2) specific issues that are relevant, should an ETP contractor file for bankruptcy. This memorandum is not meant to address circumstances relevant to any particular company, but is instead intended to focus on general questions that could arise whenever a prospective contractor appears to the Panel to present a picture of financial instability.

## Panel Discretion

Under Unemployment Insurance (UI) code section 10200(a)(3), the Panel is mandated to fund projects that will result in secure jobs for those who successfully complete training. Further, the Panel is mandated to give funding priority to projects that “best meet” certain economic development goals, among which is the priority to “promote the retention and expansion of the state’s manufacturing workforce.” (UI code section 10200(b)(7).) The cited provisions in the Panel’s enabling legislation require the Panel to use its considered judgment in awarding funding to projects resulting in secure jobs. Since there can be no absolute certainty as to job security, the Panel looks at such indicators as turnover rate, employer commitment to training, etc. Given the above, the Panel acts well within its permitted discretion to question the financial ability of a potential contractor to maintain its workforce. Similarly, the requirement to fund projects that “best meet” the goal to retain and expand the manufacturing workforce indicates that the Panel may reject funding for projects that appear not to meet that goal effectively.

Underscoring the intent of the Legislature to give the Panel latitude in considering projects is UI code section 10205(d), which identifies a Panel mandate to “Fund training projects that best meet the priorities identified annually.” The priorities identified annually are found in the Panel’s Strategic Plan. The Strategic Plan for 2002-03 states on page 3 that ETP shall target funds to ensure secure, well-paying jobs for California workers in a statement of ETP guiding principles that inform all Panel funding decisions.

The reiteration in the ETP enabling legislation of the Panel's responsibility to fund projects where secure jobs will result provide ample indication of Panel discretion to consider the financial stability of an applicant for ETP funds. Where there is evidence that a company seeking funding may be involved in insolvency proceedings, the issue of job security must be considered by the Panel as part of its mandate to award training projects to enterprises that "best meet" its funding requirements.

It has been the usual practice of the Panel to inquire into whether a potential contractor, for numerous reasons, may face difficulty in successfully completing an ETP-funded training project. Although, as noted below, the Panel may not include in its training agreements a provision for termination predicated on the filing of a bankruptcy petition, there is nothing in the bankruptcy law prohibiting consideration as to whether a contract will be performed pursuant to its terms and conditions. When the possibility of insolvency is present, the Panel is well within its jurisdiction to condition payment on performance.

Included below is a listing of specific bankruptcy-related issues that the Panel has raised in connection with approval of training projects. The topics covered relate to particular questions that the Panel has raised in connection with approving an agreement with a company that may be involved in bankruptcy proceedings during the term of the contract.

1. Can the Panel require that a contract provision contemplating termination because of a filing of a bankruptcy petition by a potential contractor be included in an ETP training Agreement?

*No. Such a provision predicated on the filing of a bankruptcy petition would be considered discriminatory under federal Bankruptcy provisions. However, the Panel could (and has in the past) required contract provisions connected to performance, such as withholding reimbursement until the contract is fully performed.*

2. If an ETP contractor receives an unearned progress payment and then files a bankruptcy petition, would the progress payment become part of the bankruptcy estate?

*Yes. The Bankruptcy Court generally regards debt resulting from a contractual relationship as subject to the claim process. As an unsecured creditor, ETP's claim would be in line for distribution of assets with other unsecured creditors.*

3. When the parent company of a wholly-owned subsidiary files a bankruptcy petition, is the subsidiary included in the bankruptcy proceedings?

*Prior to the filing of the petition(s), it is extremely difficult to foresee whether a particular subsidiary of a parent company will be included in bankruptcy proceedings filed by the parent. The defining issue appears to be the degree of involvement by the parent in the subsidiary enterprise. In ETP's history, there have been parent company bankruptcies that have included all subsidiaries, but that situation has not uniformly been the case.*

4. Is it possible for an ETP contractor that has filed for bankruptcy protection to continue to perform under the terms and conditions of the ETP Agreement?

*Yes, in a Chapter 11 reorganization, the bankruptcy trustee may, (with court approval) elect to either reject or assume an executory contract. (An executory contract in the context of bankruptcy is generally defined as a contract in which significant performance remains due from both parties.) If the trustee elects to assume the contract, the bankrupt party will continue performing the contract. In the event that the contract is rejected, ETP would file a Proof of Claim for monies due under the ETP Agreement. In a Chapter 7 bankruptcy, the assets of the bankrupt party are liquidated, and there is no assumption of executory contracts. Again, a Proof of Claim would be filed with the Bankruptcy Court for funds due. As an unsecured creditor, ETP is not in a preferred position for distribution of assets.*

5. Does ETP's position as a government agency give it any priority as a creditor in bankruptcy proceedings?

*No. Priority is given to certain tax claims submitted by governmental units, but ETP is not in a position to claim that priority.*

#### Conclusion

Since the Panel is mandated to promote secure jobs for trainees and since the Panel has discretion to examine financial viability and stability of applicants for training project funds, it is reasonable to take responsible action to assure that ETP funds will not be expended where job security is in question. In order to avoid a situation where a contract may not be performed because of the financial instability of a particular company, the Panel may predicate payment on full performance. If, during the course of the project, the financial stability of the company is no longer in question, the company may request approval of an amendment permitting progress payments commencing at the time that the company has completed 50 or 75 percent of the training. While the Panel may not discriminate because of a bankruptcy filing, the Panel must continue to comply with its enabling legislation, and assessing the performance potential of applicants for training projects is a valid basis for approving or rejecting those projects.